

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0482
Individual Income Tax
For the Tax Year 1999

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ISSUE

I. Taxpayer's Indiana Income Tax Exemptions.

Authority: IC 6-3-1-3.5(a)(3), (4); IC 6-3-1-3.5(a)(5)(A); IC 6-8.1-3-3(a); Johnson County Farm Bureau v. Dep't of Revenue, 568 N.E.2d 578 (Ind. Tax Ct. 1991); 45 IAC 3.1-1-5(b)(4).

Taxpayer argues that the Department erred in its assessment of additional income taxes on the ground that taxpayer overstated the number of exemptions claimed on his 1999 Indiana individual income tax return.

STATEMENT OF FACTS

Taxpayer filed a joint 1040 federal return reporting income received during 1999. On the 1040 return, taxpayer claimed three exemptions. Taxpayer claimed himself, his wife, and one dependent child as exemptions. Nevertheless, taxpayer states that he was entitled to claim four exemptions on the federal return.

Thereafter, taxpayer filed a joint IT-40 state return reporting income received during 1999. On the IT-40 return, taxpayer claimed four exemptions including an "additional exemption" for a total of two dependent children.

On July 30, 2002, the Department issued taxpayer a notice of "Proposed Assessment." The assessment of additional taxes was apparently based on the facial inconsistency between taxpayer's federal and state 1999 returns. The Department's notice stated that, "We have compared the federal adjusted gross income and exemptions reported on your federal and state tax returns for the indicated taxpayer period. These amounts do not agree as they should."

Taxpayer protested the additional tax assessment, an administrative hearing was conducted, and this Letter of Findings results.

DISCUSSION

I. Taxpayer's Indiana Income Tax Exemptions.

In preparing his 1999 federal return, taxpayer determined – for reasons not immediately relevant – that it would be advantageous to claim three exemptions on his federal return despite believing that he was legitimately *entitled* to claim a total of four exemptions. On his federal return, taxpayer claimed himself, his wife, and the first of his dependent children as exemptions. Taxpayer chose not to claim a second dependent child on the federal return.

However, taxpayer argues that he was legitimately entitled to claim all four exemptions on his state return even though he chose to claim only three on the corresponding federal return. Taxpayer maintains that his decision, not to claim the second of his two dependent children on the federal return, did not preclude him from claiming that second child on the state return.

Insofar as relevant to taxpayer's "Line 8" deductions, IC 6-3-1-3.5(a)(3), (4) states that the Indiana taxpayer is to "Subtract one thousand dollars (\$1,000), or in the case of a joint return filed by a husband and wife, subtract for each spouse one thousand dollars (\$1,000). Subtract one thousand dollars (\$1,000) for each of the exemptions provided by Section 151(c) of the Internal Revenue Code. Insofar as relevant to taxpayer's "Line 9" deductions, IC 6-3-1-3.5(a)(5)(A) permits an Indiana taxpayer to "subtract one thousand (\$1,500) for each of the exemptions allowed under Section 151(c)(1)(B) of the Internal Revenue Code for taxable years beginning after December 31, 1996."

The statutory formula is straightforward; an Indiana taxpayer may claim a \$1,000 exemption on line 8 of his Indiana return if that exemption is allowed under I.R.C. § 151(c). The Indiana taxpayer may claim a \$1,500 deduction on line 9 of his Indiana return if that exemption is allowed under I.R.C. § 151(c)(1)(B). There is nothing apparent in the statute which requires – as a condition precedent to claiming those Indiana exemptions – that the taxpayer first claim the identical exemptions on his federal return.

The explanatory language on the 1999 IT-40 return is equally straightforward; line eight on the form states that the taxpayer is to report the "[n]umber of exemptions claimed on your federal return." The IT-40 also states that the taxpayer is entitled to claim an [a]dditional exemption for certain dependent children" and to report that number on line nine.

Relevant to line eight, the Department's accompanying instructional booklet states that, "You are allowed a \$1,000 exemption on your Indiana tax return for each exemption *you claim on your federal return.*" (*Emphasis added*). Relevant to line nine, the booklet states that, "An additional exemption, which has been increased to \$1,500, is allowed for certain dependent children."

On their face, the IT-40 directions would seem to preclude taxpayer from claiming the second dependent child – a total of four exemptions – on his state return when he declined to report the otherwise qualifying second dependent child on the federal return. The mandatory nature of the instructional language is reinforced by 45 IAC 3.1-1-5(b)(4) which directs the taxpayer to "[s]ubtract \$1000 for each exemption taken on the Federal return for taxpayer or spouse aged 65

or above . . .” and to subtract “\$500 [now \$1,500] for each exemption *taken on the Federal return* for a qualified dependent.” (*Emphasis added*).

The instructions printed on the Indiana tax form, the accompanying instructional booklet, and the Department’s regulation preclude an Indiana taxpayer from claiming an exemption unless the exemption has also been claimed on the corresponding federal return. The tax form, the instructional booklet, and accompanying regulation have interposed an additional requirement – not immediately apparent on the face of the statute – that the Indiana taxpayer claim the exemption on the federal return before claiming the exemption on the Indiana return.

The legislature has delegated to the Department the authority to interpret and apply the tax statutes. IC 6-8.1-3-3(a) states the “The department shall adopt, under IC 4-22-2, rules governing: (1) the administration, collection, and enforcement of the listed taxes; (2) the interpretation of the statutes governing the listed taxes; (3) the procedures relating to the listed taxes; and (4) the methods of valuing the items subject to the listed taxes.”

There is nothing to indicate that the Department acted beyond its authority in promulgating a regulation mandating that Indiana taxpayers first claim the exemption on their federal returns before claiming the exemption on the corresponding Indiana return. Specifically, there is nothing to indicate that the Department acted beyond the scope of its authority in noting the discrepancy between taxpayer’s federal and state 1999 returns and rendering an additional assessment based upon that discrepancy. “A rule issued by an agency pursuant to its statutory authority to implement the statute has the force of law.” Johnson County Farm Bureau v. Dep’t of Revenue, 568 N.E.2d 578, 584 (Ind. Tax Ct. 1991).

Taxpayer argues that the “spirit of the Indiana law allows exemptions where they are qualified and [does not] intend to deprive taxpayers of receiving an exemption but for the taxpayer’s own decision to forego a qualifying exemption on their federal return.” Taxpayer makes an argument – based on general principles of equity and fairness – that the Department circumvent the regulation and permit taxpayer to maximize the tax advantages attendant on his decision to claim three exemptions on his 1999 federal return. The Department has no such equitable authority and must decline taxpayer’s request.

FINDING

Taxpayer’s protest is respectfully denied.